

Section 25137 is amended to read:

§ 25137. Other Apportionment Methods.

(a) Special Rules. In General. Section 25137 provides that if the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more of the factors;
- (3) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Section 25137 permits a departure from the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act only in limited and specific cases.

Section 25137 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment and allocation provisions contained in these regulations.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics and so forth, the foregoing regulations in respect to the apportionment formula do not set forth appropriate procedures for determining the apportionment factors. Nothing in Section 25137 or in the Regulation shall preclude the Franchise Tax Board from establishing appropriate procedures under Sections 25129 to 25136 inclusive, for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

(b) Special Rules. Property Factor.

(1) The following special rules are established in respect to the property factor of the apportionment formula:

(A) If the subrents taken into account in determining the net annual rental rate under Regulation 25130(b) produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Franchise Tax Board or requested by the taxpayer.

In no case, however, shall such value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

**Example:** The taxpayer rents a 10-story building at an annual rental rate of \$1,000,000. Taxpayer occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or \$200,000.

(B) Except as provided in subsection (C), if ~~IF~~ property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property—a rental rate that would be negotiated at arm's length between a willing lessee and willing lessor, where neither party is related or under duress, in an open and competitive marketplace for similar properties for the taxable year at issue. For purposes of the preceding sentence, "nominal rate" shall mean a token payment that is without any reasonable connection to a rental rate that would be negotiated at arm's length between a willing lessee and willing lessor, where neither party is related or under duress, in an open and competitive marketplace for similar properties for the taxable year at issue.

(C) If a taxpayer enters upon property owned by others for the purposes of extracting natural resources such as timber, oil, gas or hard minerals, irrespective of whether such entry or extraction is pursuant to a lease, contract or other agreement between the holder of the interest in the property and the taxpayer (and also irrespective of whether such relationship is characterized as a *profit à prendre* or some other relationship), consideration actually paid by the taxpayer to the holder of the interest in the property that constitutes a sharing of current or future production or extraction of the timber, oil, gas or hard minerals from such property (irrespective of the method of payment or how such consideration is characterized, whether as a royalty, advance royalty, rental or otherwise) and consideration actually paid by the taxpayer for the right to enter the property and extract the timber, oil, gas or hard minerals (such as forest management fees, fire protection fees, reforestation or reclamation fees, road maintenance fees, etc.) for the taxable year at issue shall constitute the net annual rental rate. Improvements shall not be included in the calculation of a net annual rental rate, but are separately accounted for under California Code of Regulations, title 18, section 25130, sub. (b)(5). The net annual rental rate shall then be multiplied by eight (8) in accordance with Revenue and Taxation Code section 25130.

(D) If a taxpayer makes a one-time lump sum payment under Section 25137(b)(1)(C), such payment will not be considered nominal, and will be governed by the standard apportionment rules under section 25130.

**Example:** On December 31, 2000, a taxpayer engaged in the paper products business enters into a 50-year forest management agreement with a government entity to commence January 1, 2001, that allows it to extract 100,000 cords of timber per year from forests owned by that government entity. In exchange for the right to enter the government's land and extract timber, the taxpayer agrees to pay a royalty fee of \$10.00 per cord extracted, plus a \$10,000 per year access fee, \$10,000 fire protection fee for any fires caused by the taxpayer, and an additional reforestation fee of 10 percent of the royalty fee paid. The forest management agreement also requires the taxpayer to make \$1 million worth of improvements to an existing mill facility owned by the government entity. In taxable year 2001, the taxpayer extracts 50,000 cords and does not cause

any fires to occur. It also makes the \$1 million in improvements to the existing mill facility. The taxpayer therefore pays the government entity the \$10,000 access fee, \$500,000 in royalty fees (\$10.00 per cord times 50,000 cords), and an additional \$50,000 for the reforestation fee (10 percent of the \$500,000 royalty fee). Under these facts, the taxpayer is entitled to claim \$560,000 as the net annual rental rate. The taxpayer reports \$4,480,000 (\$560,000 multiplied by 8) for property factor purposes for this property for taxable year 2001. In addition, the taxpayer reports the \$1 million in improvements in the property factor as property owned by the taxpayer in accordance with California Code of Regulations, title 18, section 25130, sub. (b)(5), for taxable year 2001.

(c) Special Rules. Sales Factor.

(1) The following special rules are established in respect to the sales factor of the apportionment formula:

(A) Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business, such gross shall be excluded from the sales factor. For example, gross receipts from the sale of a factory, patent, or affiliate's stock will be excluded if substantial. For purposes of this subsection, sales of assets to the same purchaser in a single year will be aggregated to determine if the combined gross receipts are substantial.

~~1.~~ For purposes of this subsection, a sale is substantial if its exclusion results in a five percent or greater decrease in the sales factor denominator of the taxpayer or, if the taxpayer is part of a combined reporting group, a five percent or greater decrease in the sales factor denominator of the group as a whole.

~~2.~~ For purposes of this subsection, a sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently.

(B) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless such exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include or exclude from the sales factor gross receipts from such transactions as the sale of office furniture, business automobiles, etc.

(C) Where the income producing activity in respect to business income from intangible personal property can be readily identified, such income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation 25134(a)(1)(A)) and income from the sale, licensing or the use of intangible personal property (Regulation 25136(b)(4)).

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, such income cannot be assigned to the numerator of

the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, such dividends and interest shall be excluded from the denominator of the sales factor.

(d) In cases deemed appropriate by the Franchise Tax Board it may elect to hear and decide petitions filed pursuant to Section 25137 instead of having this function performed by the staff. As a condition to having such petition considered by the Board, the petitioning taxpayer shall waive in writing the confidentiality provisions of Section 26451 with respect to such petition and to any other facts which may be deemed relevant in making a determination. Consideration of said petitions by the Board shall be in open session at a regularly scheduled meeting.

Note: Authority cited: Section ~~26422~~19503, Revenue and Taxation Code.  
Reference: Section 25137, Revenue and Taxation Code.